Testimony of Thomas D. Hammerschmidt, Jr.
House Commerce Committee
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My name is Tom Hammerschmidt, and I'm a partner in the Dickinson Wright law firm in Ann Arbor, Michigan. My practice spans over 25 years working in the federal and state tax arena, including specifically matters involving Michigan unemployment taxes.

I have been asked to limit my remarks to approximately 5 minutes, and to primarily focus on how the audit, determination and appeal process is supposed to work on Michigan unemployment taxes and then to contrast that with recent experience before the Unemployment Insurance Agency.

Obviously, the Agency possesses audit powers under the Employment Security Act. If the Agency discovers inaccuracies in reporting or misclassification of workers, it makes an assessment of taxes, which are formally called "a determination." Determinations by the Agency also take other forms, such as the annual notice of the contribution rate calculated for an employer. That's called a "rate determination."

If an employer believes that the Agency has erred in making a determination, the employer may appeal and request a redetermination. The employer's request for a redetermination typically points out any errors made by the Agency or presents legal authority and arguments as to why the determination is wrong. Once the Agency reviews the request for a redetermination, it issues its redetermination.

A redetermination by the Agency may be appealed and the matter is supposed to be assigned to an administrative law judge, or ALJ, operating under the State Office of

Administrative Hearings and Rules. When the matter is assigned to an ALJ, the matter is set for an administrative hearing during which the employer and Agency can present evidence through documentation and/or witness testimony, and the ALJ then makes a ruling on the redetermination. Parties are also allowed to make their legal arguments and are required to cite to the applicable laws and regulations in support of their position.

An ALJ decision may be further appealed to the Employment Security Board of Review, which can either review an ALJ decision on the record, or the Board can take additional testimony. A decision is ultimately made, which can be appealed by either party to circuit court, with a circuit court judge acting as sort of a "court of appeals" to determine whether the ALJ and Board of Review has ruled correctly. Presumably, the employer and the Agency are then bound by a final, unappealable, decision.

That's what's supposed to happen, now, here's what has happened to Axios and numerous other employee leasing companies in the State of Michigan. First, audits are often conducted and the Agency's auditors complete their work. The PEOs I am directly familiar with have had no issues raised by the auditors, rather, they get a call like Axios did from the Agency's tax office indicating that the PEO has somehow violated the spirit of the law. Many have been overtly accused of fraud and SUTA Dumping, A determination in the nature of an assessment typically follows stating that the Agency will treat separate corporations and legal entities as a single employer. The Agency typically issues a retroactive tax assessment going back many years and using one or two consolidated contribution rates applicable to the multiple entities. The determinations assert fraud penalties, either three or four times of the taxes that are asserted, turning a high six-figure tax assessment into a $5 million liability, with penalties and interest, or a four and one-half million dollar assessment into a $30 million liability, as the Agency has done

in another case. Even a company like Axios, which was initially told that it had not done anything fraudulent, gets hit with huge penalties.

In Axios' case, the Agency consolidated its accounts and shut down accounts for many of its companies, at the beginning of 2008, a full six months before the determination was ever issued. The Agency has done this in other cases, including causing delays and other problems with laid off workers' unemployment benefits. What Dan also did not mention is that one consequence of the Agency shutting down unemployment accounts was to create a disconnect between the state unemployment filings and the federal unemployment tax administered by the Internal Revenue Service. Axios had to do battle with the IRS and convince the IRS that the Unemployment Agency filed incorrect information with the IRS, a battle that Axios eventually won, but only after involving and spending money on its accountants and attorneys.

The so called SUTA Dumping asserted by the Agency has not occurred here. SUTA dumping involves artificially manipulating the contribution rates of corporations, by acquiring shells, and shifting employees between companies to take advantage of lower contribution rates. Some of the ALJ decisions being circulated by the Agency may have had those elements of wrongdoing. It's hard to tell from some of the decisions. What the Agency has not shared with you, however, are copies of the early ALJ decisions holding that the Agency cannot consolidate the rates of separate legal entities, where no shifting of employees or SUTA dumping has occurred. The first two cases going to an ALJ decision held exactly that, the Agency has no statutory or regulatory authority to consolidate. Those cases were appealed by the Agency to the Board of Review, where they have sat for years. The Agency just keeps moving on to another PEO, some of which may get their day in court, and others like Axios just deal with the

consequences of being declared guilty and are subject to consolidation without ever getting a hearing.

I'll wrap up my comments with this observation. HB 4951 does not attempt to reverse the 2005 anti-SUTA dumping legislation. Nor does the Bill attempt to limit the Agency's authority to deal with intentional SUTA dumping, shifting of employees and the like, as the Agency is required to do under both federal and state law. What HB 4951 does attempt to do is to clarify that the Agency has no legal authority to consolidate the rates of separate entities if there has not been wrongdoing through intentionally shifting employees, using shells and other devices to reduce unemployment tax contributions. As the ALJ stated in the lead case on this subject, using separate legal corporations for legitimate business purposes, mostly driven by workers compensation insurance issues, is not fraudulent activity. Unless the Agency proves deliberate SUTA dumping, there is no authority to consolidate or combine the rates of separate companies. The Agency's authority to do that was amended out of the statute back in the 1950s. HB 4951 is specific in its terms, if there has not been employee movement or intentional activity engaged in for the purpose of reducing unemployment taxes, the Agency cannot consolidate and certainly should not have the authority to unilaterally close accounts, issue consolidated rates, and put tax liens on companies without abiding by the appeal process established by statute.

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